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Pensions & Investments

The Newspaper of Corporate and Institutional Investing — $8 An Issue / $127 A Year

AT DEADLINE

UAL pilots cut profit-sharing

The United Airlines pilots' association will take up to $270 million in cuts in future contributions to a profit-sharing plan to help pay for its part of the proposed acquisition of UAL by employees.

The commitment doesn't involve the pilots' defined benefit fund, or any of the company's other two union's pension assets.

PacTel mulls in-house move

The $10.5 billion Pacific Telesis pension fund might begin managing a portion of its pension assets internally, said E. Douglas Taylor, executive director of investment management. The fund is interested in internal management mainly because of the potential cost saving.

Exxon audit sought

The Washington State Board of Investment is seeking an independent environmental audit of Exxon operations and facilities, noting more than $1 billion in oil spill costs has been charged against the company's 1989 earnings.

The board owns and actively manages 164,600 shares of Exxon stock and has an additional 925,000 shares in a mutual fund.

Cross-border trades backed

The International Councils of Securities Dealers and Self-Regulatory Associations endorsed common standards for clearance and settlement of securities transactions in all countries.

That action supports efforts by the Group of Thirty to promote the growth of cross-border equity trading by speeding the clearance and settlement process and reducing risk to participants.

Funds announce hires

The $85 million Enron Corp. pension fund hired Morgan Stanley Asset Management to run $8.5 million in international equities in its first overseas commitment, to be funded from cash flow.

The $180 million EG&G Inc. savings plan has invested about $35 million in the Putnam Cos.' Guaranteed Horizon Trusts. The assets came from internally managed GICs; GICs still comprise 75% of the savings plan.

Separately, EG&G's $320 million pension fund invested about $20 million total with two funds of JMB Institutional Realty and one offered by Lehndorff & Babson Real Estate Counsel. The move triples the fund's realty exposure to 15%.

Stock lending meeting set

U.S. banking representatives and Labor Department officials will meet April 25 to discuss the bankers' request to change four key constraints on foreign stock lending by U.S. corporate pension funds. The Labor Department tentatively rejected the proposals in January, but invited more discussion on the matter.

Massachusetts enters takeover fray

Bill would mandate classified boards

By Hillary Durgin

BOSTON — In yet another state's swipe at shareholder rights, the Massachusetts Legislature is poised to pass a bill that would virtually bar takeovers achieved by ousting management through an annual proxy vote.

The bill would require all Massachusetts companies to have "classified boards," which allow only one-third of a company's directors to be re-elected annually. An acquiring company would have to wait at least two years before gaining a majority on the board sympathetic to the takeover. Also, the bill would permit directors to opt out of the classified board provision, but would deny that right to shareholders.

No other state has a law mandating classified boards, and while some states permit them, shareholders have the right to vote on them.

The Massachusetts bill is fueling institutional investors' call for federal regulators to halt the piecemeal enactment of state laws they say are trampling shareholder rights.

The Massachusetts bill follows close on the heels of a heated debate over a pending Pennsylvania bill that would require companies that engage in an unsuccessful takeover to disgorge any short-term gains to the target company. The Pennsylvania bill also has an amendment that would make proxy fights extremely expensive for shareholders.

"My view is that the impact of (the Massachusetts) bill is nothing less than the partial nationalization of Massachusetts business corporations," Nell Minow, general counsel for Institutional Shareholder Services Inc., Washington, said in testimony before a hearing of the state's Senate Commerce and Labor Committee last week.

"These directors become the absolute rulers of the enterprise for a period of at least two years. They cannot be removed, they are accountable to no one, they have unfettered control of the corporation's assets," Ms. Minow said.

The Massachusetts bill, H. 5556, was drafted in response to the March 29, $1.6 billion hostile takeover bid for Norton Co., a Worcester, Mass., abrasives manufacturer, by London-based BTR PLC. The British conglomerate has said it would wage a proxy battle at Norton's April 26 annual meeting. If the legislation is passed, BTR would be unable to gain the two-thirds majority on the board necessary to oust Nor-

See **Takeover** *on page 35*

Institutional investors will be closely watching General Motors Corp. and Robert Stempel, its new chairman, for signs of a turnaround.

'90 proxy victories leave key questions

By Marcia Parker

Analysis

The conclusion of two of the most significant proxy fights of the season — at Lockheed Corp. and Xtra Inc. — and a changing of the guard at General Motors Corp. raise a key question: How will institutional investors react to whatever changes management masterminds to rejuvenate the three struggling companies?

All three companies have performed poorly, and their top executives have been criticized for mismanagement. New strategic plans, some still being developed, will have to be put to the test. Whether institutional investors will stick with them depends on results.

Lockheed's management, led by Chairman Daniel Tellep, and the new chieftains of Xtra Inc., led by President Lewis Rubin, both owe their jobs largely to institutional investors. Robert Stempel, newly named successor to GM Chairman Roger Smith, also will face institutional shareholder pressure to bolster the auto company's lackluster performance.

Institutional investors, who have seen the value of their holdings in these three companies plummet or stagnate at best, vow to keep the pressure on.

Lockheed's profitability problems are aggravated by negative defense industry trends. Analysts say profitability can be improved and assets better managed, but it will take tough measures. Executives predict a strong earnings rebound in 1990, continued improvement down the road and no write-offs. Whether they can deliver is another question.

Also uncertain is the role in the restructuring of three as-yet unnamed directors. Their appointments will be controlled by institutional investors, who won that concession from management in exchange for their support in the proxy battle.

Institutional shareholders who played a key role in the proxy fight — including the California Public Employees' Retirement System, the New York City Employees' Retirement System and the Florida State Board of Administration — are making sug-

See **Reaction** *on page 32*

JMB gets seat on Federated's committee

By Steve Hemmerick

JMB Institutional Realty Corp., Chicago, seeking to protect the financial interests of its clients that own regional malls through JMB, has acquired a seat on the unsecured creditors committee for Federated Stores Inc.

Federated Stores — formerly Campeau (U.S.) and the holding company for the Federated Department Stores Inc. and Allied Corp. subsidiaries of the ailing Toronto-based retailing giant Campeau Corp. — filed for protection from creditors in January under Chapter 11 of the Federal Bankruptcy Code. Both department store chains have stores in regional malls managed by JMB for pension and endowment funds.

An unsecured creditors' committee is one of several committees that can make its opinions known to a judge deciding the outcome of a Chapter 11 reorganization.

Real estate consultants and advisers say Campeau's problems might affect the values or income of retail malls where Campeau stores are located.

Through its group trusts and Cadillac Fairview holdings, JMB manages and has ownership interest on behalf of its clients in 12 malls in which Campeau's stores operate.

The extent of JMB's own corporate interests in Campeau isn't known. Last July, however, prior to the Chapter 11 filings, Campeau officials announced JMB Realty Corp., an affiliate of JMB Institutional, and Campeau had reached an agreement on six new joint ventures that involved opening a number of new department

See **JMB** *on page 32*

NEWS DIGEST

Real estate consultant Stephen Roulac has turned his bicycling avocation into a business venture. Page 6.

A Virginia law requiring public funds to disclose investment-related information has been diluted significantly from its original intent. Page 28.

Pan Am World Airways, for the sixth time in 10 years, is seeking permission from the Internal Revenue Service to delay its pension contribution. Page 35.

SPECIAL REPORT: PROXIES 1990

The proxy voting system in the U.S. and abroad is under fire from both shareholders and government leaders as institutional investors' clout — buoyed by several early 1990 victories — is beginning to be felt. Page 19.

FINANCING

With traditional refinancing sources drying up, investment banks are turning to institutional investors in the private placement market to buy bridge loans. Page 3.

INTERNATIONAL

A record $20 billion is expected to be pumped into international investing by U.S. institutions despite recent slides in many foreign markets. Page 2.

West German companies' use of restricted shareholder voting is coming under pressure. Page 19.

REAL ESTATE

JMB Institutional Realty Corp. has secured a spot on the unsecured creditors' committee of Federated Stores to protect its interests and those of its clients. Page 1.

California Public Employees' stake in Santa Fe Pacific Realty gives it access to major developments. Page 3.

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International alert

Questionnaires for *Pensions & Investments'* annual directory of international and global investment advisers were mailed April 10. The deadline for inclusion in the directory, to be published June 25, is May 13. If you have accounts invested overseas and have not received a questionnaire, contact Christine Philip at (312) 649-5217.

Bargain hunters stalk junk market

By Marlene Givant Star

A few pension funds are entering the high-yield market for the first time or increasing existing commitments to take advantage of what they consider irresistibly low prices.

Like a punch-drunk boxer, the public junk bond market is slowly regaining its footing: The riskier zero-coupon sector is firming; high-yield mutual funds are seeing cash inflows for the first time in months; and equity capital is more attractive to speculative-grade companies than debt.

The private high-yield market also is strengthening, as evidenced by an increase in commitments to midsize "story deals" — or situations needing detailed explanation.

This year, at least three pension funds have entered the high-yield market for the first time. The trio hired Delaware Investment Advisers, Philadelphia, which manages $1.75 billion in high-yield bond investments for institutions, as well as a $600 million junk bond mutual fund. And six of the firm's existing clients, including General Motors Corp., funded their previous commitments this year.

In addition, the $10.5 billion Pacific Telesis Group pension fund, San Francisco, increased its commitment to junk bonds at the end of 1989 after fortuitously cutting back in the spring.

"High yield as a strategy has really had its rewards for us in the past four to five years," said E. Douglas Taylor, executive director-investment management at PacTel. "We thought the market break in the fourth quarter was a common overreaction. It caused us to raise our commitment at year end," by increasing the size of existing managers' accounts.

Mr. Taylor described the managers' performance as stellar, but declined to name the firms. Last year, the fund's high-yield accounts "did a heck of a lot better than the high-yield market. This year hasn't been bad."

Many believe the market is irrationally depressing the prices of big-name credits that have never had trouble making their coupon payments.

"No one's going to stop wearing underwear," said J. Michael Pokorney, vice president and senior portfolio manager of Delaware, noting that companies like Playtex Apparel Inc., American Standard Inc., Anchor Glass Container Corp., and Chiquita Brands Inc. are selling at a bargain 80 cents on the dollar.

To be sure, the market is still fragile. Brokerage firms are expected to unload their high-yield inventories soon, the new issue calendar is virtually empty, the secondary market is extremely thin and interest rates remain at prohibitively high levels for many issuers.

But junk prices can react strongly to even a small increase in investor demand because of the dearth of high-yield paper. "Technical factors are positive, and the recent strength in zeroes, a leading indicator for our market, suggests a sustained trend of improvement," noted a high-yield market commentary report from Donaldson, Lufkin & Jenrette Securities Corp., New York.

"The market's beginning to get its feet back on the ground. Because of that, people tend to look for incremental yield (on stronger credits) as an outgrowth of the market feeling a little better," said Steven Shenfeld, a high-yield bond trader at DLJ.

Debt buybacks by speculative-grade companies also could boost market sentiment. Brian Doyle, director-high-yield bond research

See **Junk market** *on page 35*

Global arena still attracting U.S. funds

By Margaret Price

Undeterred by the Japa market's near free fall, recent slides in some maj European markets, U.S pension funds seem inte on increasing their overs foreign investments th year.

A recent survey by Inte Sec Research Corp., Stam ford, Conn., predicte 1990's net cash inflow in international investmen

See **Overseas** *on page 3*

FT-Actuaries World Indexes

Dec. 29, 1989-April 9, 199

Tot ns rate (in U.S. $ ter

Australia	-7.91
Austria	53.84
Belgium	-3.80
Canada	-6.37
Denmark	4.37
Finland	2.74
France	4.73
Hong Kong	5.80
Ireland	3.94
Italy	1.60
Japan	-29.85
Malaysia	-8.35
Mexico	20.35
Netherlands	-1.94
New Zealand	-12.53
Norway	16.43
Singapore	5.20
South Africa	-4.29
Spain	-12.35
Sweden	-5.48
Switzerland	-1.62
United Kingdom	-5.36
United States	-2.66
West Germany	9.14

Source: The Financial Times Ltd.; Goldman, Sachs & Co. and County Nat West/Wood Mackenzie

GIC meeting becomes hostile

Tempers flare in debate over value of active manageme

By Fred Williams

NEW ORLEANS — The bad blood that exists among participants in the guaranteed investment industry surfaced at a recent conference that was anything but sanguine.

"It is ludicrous to think that a plan sponsor who looks at the market one to three times a year can do this as professionally and effectively as we do."

David Perry

Even the chairman of the event noted the sour atmosphere among plan sponsors, managers, consultants, banks and insurance companies. Ed Rennie, executive director-trust investment at Bell Atlantic Corp. and conference chairman, regularly attends conferences about the equity and bond markets, but said he had "never seen as much hostility among participants as I've seen at this one. It is a concern to me. When we disagree, we should disagree professionally; hostility has no place."

The hostility was particularly apparent in the discussion between a pension executive and a GIC manager over whether discretionary GIC managers add value to GIC portfolios.

The at-times acrimonious debate between Robert M. Hunkeler, manager of trust investments at CIBA-GEIGY Corp., Ardsley, N.Y., and David M. Perry, president of Certus Financial Corp., San Francisco, was easily the most controversial session o Institute for International search's fourth annual GIC S posium.

Mr. Hunkeler attacked cl

See **GIC debate** *on pag*

"Our experience . . . has led us the conclusion that it is extremely unlikely a GIC manager will add v it is far more likely a GIC manage subtract value."

Robert Hunk

California fund takes active role in realty firm

Officials expect significant returns

By Steve Hemmerick

The California Public Employees' Retirement System plans to be an active player in the strategic decisions made by a real estate company in which it now owns a 20% interest.

In addition, officials expect the investment returns from the fund's stake in Santa Fe Pacific Realty Corp. to be significantly more than the 5% real return they expect from the system's average real estate holdings.

The $56 billion fund's ownership interest in the San Francisco-based real estate developer is its largest percentage ownership in any company.

The deal — completed in December — cost the fund $400 million, and included two seats on the company's board of directors. Officials from JMB Institutional Realty Corp., Chicago, which suggested the deal to the California pension fund, will serve as the fund's representatives on the board.

"It's a unique investment," said DeWitt Bowman, chief investment officer for California Employees.

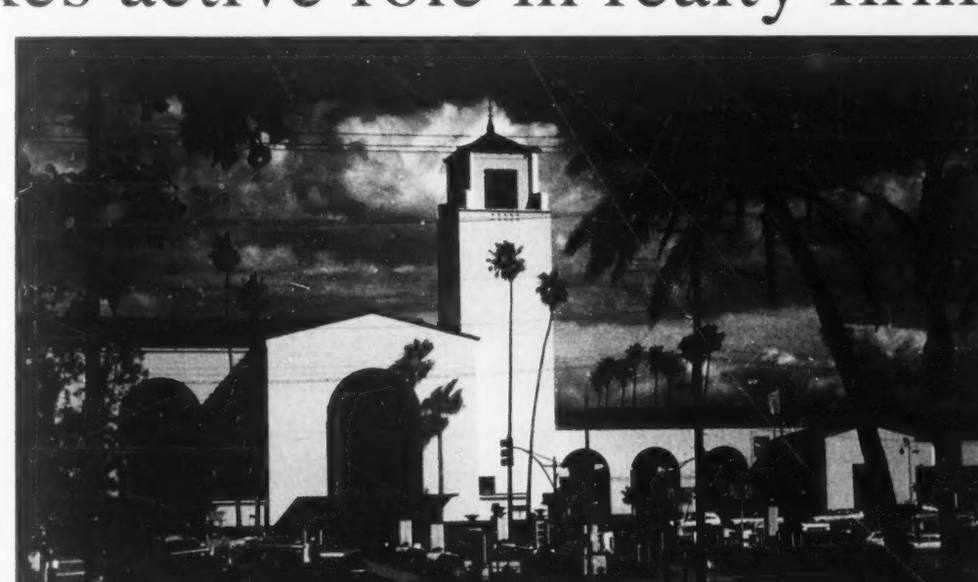
"We do really feel that as a minority partner, along with the other minority partners, we have a great deal of influence that can be made on strategy and business policy of the company," said Roger Franz, real estate investment officer for the fund.

Other shareholders with large stakes are Itel Corp., which has a 17% interest, and Olympia & York Developments Ltd., a 20% stake. Real estate mogul Sam Zell has a 25% interest in Itel.

Through the deal, the pension fund has gained access to earnings from some of the most significant real estate development deals in California.

They include:

- Development of the Mission Bay project in San Francisco, the largest development in the city's history. Santa Fe will develop industrial, office and housing at an estimated cost of $2 billion. The firm also will pay most of the $231 million need for roads, parks, community facilities and toxic cleanup. An estimated 16,000 people will live there and 23,000 will work there when Mission Bay is complete.
- Acquisition of the 51-year-old Union Station on a 48-acre site in downtown Los Angeles, slated to be the hub of the city's multibillion dollar subway and light rail system. Santa Fe also acquired land surrounding the station to build offices and retail.
- Development of a hotel, office and retail complex on 17 acres surrounding the San Diego train depot. Santa Fe is spending about $1 billion there.
- Development of a $25 million, 400-unit apartment complex in San Diego, across the street from its new, $40 million Embassy Suites hotel in downtown.



Santa Fe's holdings include Los Angeles' Union Station, which will be the hub of the subway system.

With 2 million acres in 13 states, the company has enough land to build projects for 20 years, Mr. Franz said.

In addition to the $400 million paid for the 20% stake, the fund loaned the company $75 million. That loan could be paid back in the form of an even greater equity interest.

Mr. Franz said one reason the fund invested in the deal is it needs a steady stream of prime real estate projects.

Santa Fe Pacific Realty, a subsidiary of Santa Fe Pacific Corp. in Chicago, is expected to be spun off in 1992.

Governments face $1 trillion tab

By Fred Williams

A proposal that state and local governments disclose the projected costs of post-retirement health care benefits for their employees could reveal liabilities in excess of $1 trillion.

Until now, most of the attention has been focused on corporate retiree medical liabilities, estimated between $200 billion and $2 trillion. But the Government Accounting Standards Board has issued a proposal that would require state and local governmental bodies to provide disclosures about their post-retirement benefits.

The disclosure ultimately could affect state credit ratings, some experts say. According to one actuary, state and local retiree health care liabilities could easily top $1 trillion, which will have to be paid by taxpayers.

Public officials contacted by *Pensions & Investments* refused to reveal the size of the liabilities for their plans.

The proposed standard, which would be effective for fiscal years after June 15, 1990, is similar to the Financial Accounting Standards Board Statement 81, which requires corporations to disclose in financial statements how medical benefits are being paid.

The GASB proposal would require that state and local governments disclose benefits provided, employees covered and employer obligations to contribute; a description of the statutory authority under which the benefits are provided; a description of the accounting and funding policies followed for the benefits; and the expenditures for those benefits recognized for the period.

The measure is seen as temporary while the GASB, the accounting standards body for government entities, works out a standard for accrual accounting for implementation in the late 1990s.

According to a research report prepared for the GASB by the staff of the National Association of State Auditors, Comptrollers and Treasurers, Louisville, Ky., most state and local governments offer retiree medical benefits, and a great majority finance the plans on a pay-as-you-go basis.

In a survey by the association, to which officials of 38 states responded, 22 said they offered retiree benefit plans. Of the 31 small cities responding, only four had retiree plans. Of the 16 large cities responding, however, 10 offer plans.

In addition, only one respondent to the entire survey indicated it was pre-funding retiree medical liabilities.

The association's report concluded "an accrual-based ap-

See **Liability** *on page 33*

Trying to bridge the gap

Investment banks turning to private market for refinancing

By Leonard J. Hollie

Squeezed out of traditional routes of refinancing bridge loans through commercial banks or with junk bonds, some investment banks are turning to the private market and tapping institutional investors. So far, however, only a few investors have bought the pitch.

Although GE Capital Corp. has taken the lead in buying almost $250 million in bridge loans from Kidder, Peabody & Co. Inc. — both firms are subsidiaries of General Electric Co. — large institutional investors are not yet convinced of the value of these investments.

Lisa Van Orden, a spokeswoman for GE Capital, said purchasing Kidder's bridge loans, "hasn't had an adverse effect on our business." But she said, the firm does not plan to buy bridge loans from other investment banks.

"The stumbling block for institutional investors is the (selling) price of these loans," said David Bullett, vice president for the Teachers Insurance and Annuity Association, New York. Mr. Bullett said he is aware investment banks are turning to the private placement market for financing, but the one deal he has seen had an excessive price tag. He declined to elaborate.

"There will have to be some concessions made in lowering the price of these loans. They are priced at the same levels (when) the deals were struck six to nine months ago," he said. "That doesn't make much sense in light of the present economic environment."

Investment banks' outstanding bridge loans

Firm	$ millions
First Boston	700
Merrill Lynch Capital Markets	600
Shearson Lehman Hutton	600
PaineWebber	300
Salomon Brothers	200
Bear Stearns	50
Morgan Stanley	41

Source: Standard & Poor's Corp. estimates

With the public markets hard to access, analysts said investment banks are putting greater emphasis on finding private placement vehicles to raise money instead of committing their own capital. Standard & Poor's Corp., New York, estimates top brokerage houses that make bridge loans have about $2.5 billion total in outstanding loans on their books.

Perrin H. Long, securities analyst for Lipper Analytical Securities Corp., New York, said he's seeing more investment banks turn to the private market. "This is an avenue for them, though they are being secretive about doing it," he said.

Bridge loans usually are retired through permanent bank financing, junk-bond issuance and private financing with institutional investors. The loans also can be retired through the sale of the company's assets.

Analysts believe brokerage houses are being squeezed to refinance bridge loans, especially those that hold sizable amounts of junk bonds, because they are experiencing weak earnings.

"These firms no longer have ready access to the junk bond investor due to (Drexel Burnham Lambert Inc.'s) collapse, and that makes it hard to liquidate their bridge positions," said Jeffrey Bowman, vice president at Standard & Poor's. "Private placements have become attractive to them. It's starting to happen. There is one firm that is doing it now," said Mr. Bowman who declined to name the firm.

Mr. Bowman said some of the reasons for the security industry's depressed earnings include a slowdown in mergers and acquisitions, underwriting volume and institutional and retail buying.

Not surprisingly, although some brokerage firms said they will consider the private placement market as an alternative, many have been reluctant to talk about their refinancing strategy. The firms are using a variety of techniques to reduce their bridge loan exposure.

In March, First Boston Corp. sold its Swiss parent company, CS Holding, more than half of its $450 million bridge loan to Ohio Mattress Co., and analysts said First Boston plans to help corporate clients sell junk bonds in the private placement market to raise funds to pay off two other bridge loans to American Medical Inter-

See **Bridge** *on page 34*

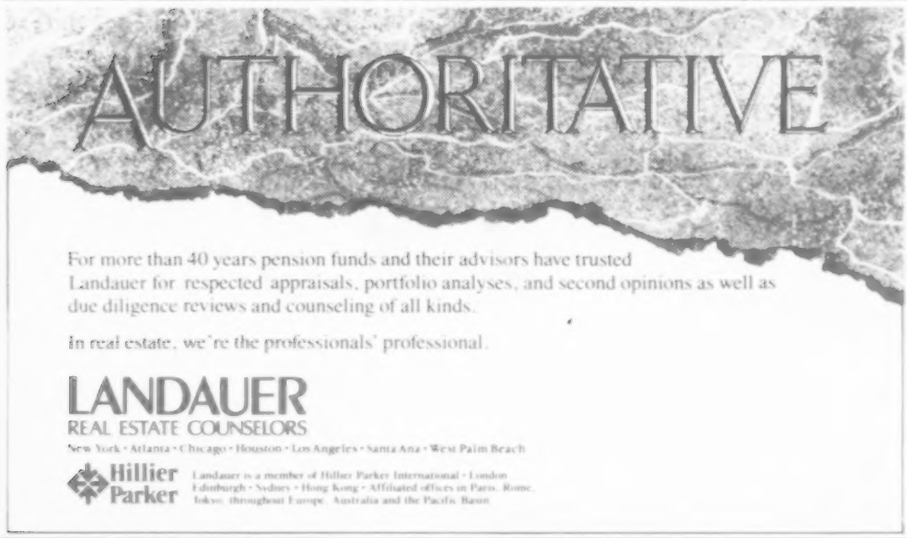
SOFTWARE

System marketing goes overseas

■ Information Systems of America Inc., Atlanta, and Spain's Entel S.A. have formed a joint venture to market ISA's Investment Management and Accounting software system in Spain and Portugal, both fast growing markets.

The ISA system is marketed as PRISM in the United States and is among the leading IBM mainframe-based systems offering multicurrency capabilities to international money managers.

Entel, an affiliate of the Spanish telephone company, is a leading developer of hardware and software. A subsidiary of United Telecom, ISA develops, markets and supports IBM mainframe investment management and accounting systems for the global financial services industry.



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LBOS

Junk bond fallout imperils banks

■ The leveraged buy-out loans of U.S. banks could be hurt by the collapse of the junk bond market, an executive of Moody's Investors Service warned.

In a recent speech in New York, Christopher Mahoney told a group of bank and financial analysts the markets' harsher attitude toward leverage will make it more difficult for cash-strapped LBO companies to refinance borrowings or to sell assets to meet obligations.

He said the rating agency is reviewing banks' portfolio exposure to LBOs and highly leveraged transactions. "The bottom line is that we are expecting LBO problems to rise substantially," Mr. Mahoney said. "Since LBO loans are generally senior and secured, the actual loss experience should be modest."

Money center banks' LBO/HLT exposure ($ billions)

	Total exposure 1988	1989
Chase	6.0	6.9
Citicorp	10.0	13.4
Bankers Trust	5.6	6.9
B of A	2.0	2.3**
Manufacturers	5.1	5.3
Chemical	3.1	4.9
J.P. Morgan	1.0	1.7**
First Chicago	1.4	4.1
Continental	1.7	5.0

**3rd quarter 1989 data

Source: Moody's Investors Service

Note: Total exposure includes outstandings, commitments, subordinated debt outstandings and equity investments.

REAL ESTATE

To buy or not to buy is the question

■ Five officers from multibillion-dollar pension plans will disclose their opinions at a New York University conference May 13-15 on whether it is a good time to invest in real estate.

The five are John W. MacMurray, senior director-pension administration, RJR Nabisco Inc.; Louise Moloney, financial analyst, U.S. Steel & Carnegie Pension Fund; James Peterson, director of real estate and alternative investments, IBM Corp.; Joseph Russo, division manager of real estate investments, AT&T; and Thomas Thompson, director of real estate investments, American Information Technologies Corp.

DeWitt F. Bowman, chief investment officer for the California Public Employees' Retirement System, will moderate the panel discussion.

The conference — NYU's first on pension funds and real estate — also will concentrate on employing modern portfolio theories in real estate.

Conference speakers on that subject include Susan Hudson-Wilson, vice president, Aldrich, Eastman & Waltch; Nori Gerardo, managing director, Pension Consulting Alliance; David McMillan, second vice president-investments, Aetna Realty Investors; and Charles W. Wurtzebach, vice president-portfolio management, Prudential Realty Group, Newark, N.J. Moderator for the MPT panel will be Michael Gilberto, vice president, Salomon Brothers Inc., New York.

HEDGING

Chase looks to score in derivatives

■ Chief financial officers and treasurers will turn to new derivative securities to hedge non-interest rate risks such as raw materials, inflation and cost-of-living increases.

"Corporate America is realizing the volatility isn't over. The static debt structure of the 1980s will be replaced in the 1990s by a dynamic debt structure . . . that can hedge operating risks," said Walter J. Mullen, the newly named managing director in charge of debt and derivatives transactions at Chase Securities Inc. in New York.

Chase Securities, the securities arm of The Chase Manhattan Bank, aims to make its mark by capitalizing on its expertise with derivatives such as interest rate swaps, caps and floors. It will focus on underwriting and selling derivative-linked securities for its top-tier corporate clients. Commercial banks long have had an advantage in the derivatives area.

Mr. Mullen recently joined Chase from Security Pacific Merchant Bank, where he managed global interest rate and currency risk. Paul Sciafani, who just came on board from Nomura Securities Inc., is managing director-investor services who heads up the institutional sales effort.

Paul Sciafani

Walter J. Mullen

Shareholder agenda: limited but powerful

By Robert A.G. Monks

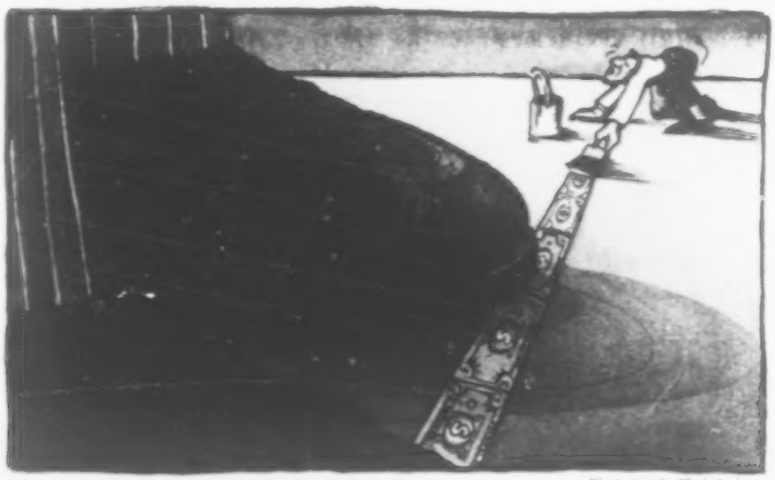

Illustration by Mark Anderson

As stocks are consolidated more and more in the accounts of enormous institutional investors, these predominant shareholders are both large enough to find active participation in ownership issues a wise investment, as well as obligated as fiduciaries to become involved. This is why it is essential to be very clear about the agenda for shareholder involvement.

Management's accountability to shareholders is what keeps it focused on productivity and competitiveness. Without accountability, there is nothing to prevent management from diverting corporate assets to its own benefit. But if management is too accountable, productivity and competitiveness can suffer. We have seen management held hostage by "takeover entrepreneurs," investors with short-term perspective whose involvement provides perverse incentives for management to take actions contrary to long-term interests of the company and shareholders.

Shareholders' most important function is the right to act on serious problems, such as in the case of an incompetent or corrupt management that must be thrown out, or in a contest for control, where one side or the other must be supported, or in the need for major restructuring.

The first and most important element of the ownership agenda, then, is protection of core process rights, to protect the right to act when necessary. Thus, shareholders must resist proposals to stagger election of directors, because this dilutes the power of stockholders to change the board of directors annually. By delaying the capacity of a majority of owners to elect a majority of directors, the staggered board structure represents an unacceptable reduction of the essential characteristic — and the value — of stock. Similarly, the authorization of several classes of stock having disproportionate voting rights dilutes the intrinsic rights-of the ordinary common stockholder and infringes on their dividend rights as well. Champion International Corp. and Polaroid Corp. are two of the recent examples of this special treatment for certain investors. Common stockholders are in this respect comparable to citizens of a constitutional democracy; their status and the value of their franchise are a function of their vigilance.

Vigilant protection of the vote is not enough. Harvard Business School Professor Jay Lorsch in his "Pawns or Potentates? The Reality of America's Corporate Boards" (200 pages, Harvard Business School Press, 1989) trenchantly demonstrates that boards of directors in reality are just another corporate department governed by the chief executive officer rather than an independent body seriously and effectively committed to long-term enhancement of ownership values.

State legislatures' endorsement of anti-takeover measures, the latest exemplified by the still-pending Pennsylvania Senate Bill 1310, obscures and dilutes the obligation of directors to manage the corporation as fiduciaries for the shareholders. As a result, it represents a dangerous threat to the integrity of our business system.

Shareholders should therefore include in their agenda in regard to the formation of boards of directors: nominating committees consisting entirely of outside directors (disqualifying affiliated outsiders, like the corporation's attorney and banker); a chairman who is someone other than the corporate chief executive officer; and a national registry of competent, independent persons willing to serve along the lines of the highly successful British organization, Promotion of Non-Executive Directors, a clearinghouse funded by institutional investors to provide candidates for director positions.

Benjamin Graham and David Dodd, in the first edition of their "Security Analysis" (1934) noted, "The choice of a common stock is a single act, its ownership is a continuing process." In their view, it was inevitable that the interests of stockholders and management would conflict at certain points and that shareholders should expect to be involved to protect their values. The agenda was defined by this inevitable conflict, which would keep it a creative tension, a system of checks and balances. The shareholder agenda should be strictly limited to these items. Owners should not be involved in operating matters.

The improved performance of Honeywell Inc. following the unprecedented defeat of "management entrenchment" proposals at its annual meeting last year provides compelling evidence that good governance is good value. ■

Robert A.G. Monks is president of Institutional Shareholder Services Inc., Washington.

Legislative disregard of investors' rights

By Robert C. Pozen

The Pennsylvania Legislature is poised to pass a new form of anti-takeover statute that strikes at the heart of corporate democracy.

The proposed statute, probably set for a vote this week, would set a dangerous precedent by threatening any shareholder who tries to persuade others to vote against a proposal by corporate management.

The Pennsylvania statute is part of a trend that has been spreading through state legislatures like a virus, a virus that in its most virulent form could kill free speech among shareholders. This "anti-takeover virus" has been spreading via the copier machine. Any takeover restriction passed in one state has been quickly copied by other states.

The states are attempting to fill the void left by the federal government's failure to respond to enormous changes in the field of mergers and acquisitions. While Congress sits idly by, states such as Pennsylvania are drastically restructuring the governance process of companies traded in the national and international markets. More than 30 states have adopted anti-takeover statutes, often in great haste at the request of a local company facing an unwelcome shareholder.

State statutes typically prohibit anyone from acquiring more than 20% of the voting stock of a locally incorporated firm without prior approval of its board. For the first time, however, the Pennsylvania law also would penalize anyone who obtains proxies for more than 20% of a company's shares. The proposed penalty is severe: handing over to the company all profits from the sale of the shares within 18 months.

For example, suppose a Pennsylvania company asks shareholders to approve a merger that seems imprudent or wasteful to an institutional investor owning 4% of the company's stock. If the institutional investor persuades owners of 17% more of the stock to vote together with it against the merger, the institutional investor would forfeit all profits on sale of that stock within the next 18 months.

Or, suppose an individual owns 15% of the stock of a Pennsylvania company and one of the company's directors is indicted for bribery. If the individual persuades owners of 6% more of the stock to vote with him against the indicted director, the individual would lose all profits on the sale of that stock within the next 18 months.

In both cases, the communication among shareholders would simply be truthful expressions of opinion, disseminated in accordance with the Securities and Exchange Commission's proxy rules. This is the essence of corporate democracy. Nevertheless, such truthful speech would be subjected to the chilling effect of a severe penalty.

What justification is there for this restriction on free speech? The sponsors of the Pennsylvania statute do not argue the statute is needed to prevent corporate raiders from taking over companies through leveraged buy-outs or bust-up mergers. Pennsylvania already has a statute that prevents anyone, without the directors' approval, from buying more than 20% of a Pennsylvania company's stock and then effecting any type of transaction with or on behalf of that company.

Instead, the sponsors argue the new restriction on proxy solicitations is needed to prevent someone from buying less than 20% of a company's stock and then extracting greenmail — forcing the company to buy back a large block of stock at a higher than market price.

If greenmail is a problem, however, Pennsylvania could pass a narrow statute that prevents a company from purchasing its shares at a premium from one shareholder unless an offer is made to all shareholders. New York has such a statute.

The real reason for the Pennsylvania bill is that local companies are worried about outsiders acquiring significant blocks of their shares. As a result of the fears of business and labor groups, the bill sailed through the Pennsylvania Senate without careful analysis, and recently passed the House without the exemptive relief sought by institutional investors. Pension funds and other institutional investors now will be pushing for such relief in the process of reconciling the House and Senate versions of the bill.

It is easy to understand the fears of Pennsylvania managers and employees about the corporate restructurings that have occurred in the past decade. Statutes such as the one proposed in Pennsylvania, however, are irrational responses to these fears. Many corporate restructurings are related to fundamental forces beyond the control of any state legislature — dramatic changes in technology and the competitive position of the United States.

While there are abuses in the takeover process that need to be corrected, these reforms should be made by Congress. Only Congress can balance the interests of incumbent managers and local employees against the interests of national investors and international competitors. Concerned as they must be with tax revenue and employment within their state's borders, state legislators should not be setting the ground rules for the governance of U.S. corporations. ■

Robert C. Pozen is general counsel of Boston-based FMR Corp. and a managing director of its Fidelity Investments.

LETTERS

Southland Corp. confusion

■ In "Distressed opportunities plentiful in the '90s" (March 5), I listed "Southland" as being in default, causing confusion with companies with similar names. It is Southland Financial that is in default.

Martin D. Sass
M.D. Sass Investors Services
New York

Firm in wrong asset group

■ Your Scorecard report (Feb. 5) incorrectly listed Fischer, Francis, Trees & Watts Inc. as a balanced manager. FFTW exclusively manages fixed-income securities. Our net new fixed-income business for 1989 was $1.18 billion.

Cecilia Murphy Baron
Fischer, Francis, Trees & Watts
New York

Editor's note: The questionnaire received from FFTW listed all assets as "balanced."

GIC debate

Continued from page 2

by GIC managers that their add value to GIC portfolios.

He said CIBA-GEIGY recently terminated its outside GIC manager, returning its $400 million in GIC assets to internal management.

Mr. Hunkeler declined to name the terminated manager, which was hired in 1987. But in the 1990 Money Market Directory, State Street Bank and Trust Co., Boston, was listed as GIC BIC manager for CIBA-GEIGY's $500 million 401(k) plan. "All the guaranteed assets are in the 401(k) plan."

"Our experience and research over the last three years has led us to the conclusion that it is extremely unlikely a GIC manager will add value; it is far more likely a GIC manager will subtract value," Mr. Hunkeler said, firing the opening shot of the debate, which at times degenerated into name-calling by Mr. Perry.

Mr. Hunkeler also disputed claims by some GIC managers that external managers relieve plan sponsors of fiduciary responsibility and that pension fund staffs cannot manage GICs as well as external managers.

And he hit hard at what he characterized as excessive fees charged by GIC managers for their services.

Mr. Perry said GIC managers add value to the portfolios through independent credit quality research and support, "market access," central administrative functions and employee communications. He said they also share fiduciary responsibility.

GIC managers add value, he said, by "giving professional, full-time support to a business that is immensely complex."

Discretionary GIC managers have captured 15% to 20% of the estimated $175 billion to $200 billion GIC market, but most GICs are managed internally.

Mr. Hunkeler said CIBA-GEIGY and other larger plans have made a commitment to internal GIC investment management staff and resources. "Outside managers may add value if the plan is small and unsophisticated and if you don't look at the fees they charge, or if you just want to delegate administrative responsibility. ... We firmly believe the claims for hiring outside (GIC) managers are unsubstantiated in the market and unproven."

Mr. Hunkeler didn't detail his fund's experience, but said he came to the conclusion that a plan sponsor can do most of the manager's job — credit research, underwriting risks, contract negotiation and execution — as well as or better than the manager, without paying the management fee.

Mr. Hunkeler said CIBA-GEIGY was being assessed about $400,000 in fees annually for managing its GIC fund.

(One consultant, however, later said that fee level — about 10 basis points — is well below the industry average. Kim McCarrell, consultant with the Wyatt Asset Services, Portland, Ore., said GIC management fees range from 20 to 50 basis points or more on assets under management.)

Mr. Perry said there are "degrees of effectiveness, and it comes down to the fact it is participant money and the performance of the fund is still an elusive endeavor. Nevertheless, we have 17 full-time people who do nothing but GIC work. Three of them measure the quality of issuers; we subscribe to all the rating information.

"We say, 'Do you want it done professionally or unprofessionally?' It is ludicrous to think that a plan sponsor who looks at the market one to three times a year can do this as professionally and effectively as we do."

Mr. Hunkeler said his fund carries between 10 and 30 contracts in its portfolio. He disputed Mr. Perry's claims that the manager's staff is somehow more attentive to contract provisions, credit quality and new products. "We have two people working on this, one plan and 30 contracts," he said. "Managers are looking at hundreds of contracts. How much time can the manager put in on individual contracts?"

Interviewed after the debate, he said, "Being able to mitigate underwriting risks is largely an understanding of cash flow. We feel the person sitting on top of cash flow, which is ourselves, is in the best and most effective position to decide which risks you would want to take." He added managers, "who don't know the cash flow, tend to create larger contract buffers which, in turn, reduce yields."

Mr. Perry said insurance carriers are more likely to contact GIC managers when they have special deals or above-market offerings than to go directly to plan sponsors. But Mr. Hunkeler characterized that claim as "pure bull," and received some unexpected support from the audience.

A representative from Metropolitan Life Insurance Co., New York, a major GIC issuer, stood to say insurance carriers do not contact "intermediaries" about special offerings. "I don't want anyone in this room to leave thinking that carriers do that," he said.

Mr. Perry said "the appeal of a GIC fund is its security, stability and lack of volatility. The fundamental reason GIC managers are hired is because plan sponsors don't want to see the blended yield of the fund go from 9% to 7%. The reasons we have been hired in the past is that the plan sponsor has concluded it is participant money, and (the sponsor isn't) going to staff up to do a professional job of managing the assets."

Mr. Hunkeler concluded by saying the question of hiring a GIC manager comes down to "a question of cost. Are you getting what you pay for? We concluded that you are not."

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Overseas

Continued from page 2

by U.S. pension funds should reach a record of $20 billion, and bring total international investments to some $105 billion.

Of that total, 85%, or $89.25 billion, would be in equities investments, and the remainder in fixed-income vehicles.

The outlook comes despite weaknesses in some key foreign stock markets, especially Japan's. Between Dec. 29 and April 9, the FT-Actuaries World Indexes fell 13.55% in total return in dollars, compared with a rise of 17.89% for all of 1989.

Japan's stock market has produced the shabbiest total return this year of the world's major markets. Others, including New Zealand, Australia and a number of European markets, also have faltered.

The dollar's rise certainly has added to the general malaise. Between Dec. 29 and April 9, the dollar advanced 9.91% against the Japanese yen and less than 1% against the deutsche mark. A higher dollar reduces the value of assets denominated in foreign currencies.

Of course, investors have noticed the double-barreled blowout from financial markets.

The $440 million pension fund of Wisconsin Electric Power Co., Milwaukee, made its first investments in the international arena in January. "Perhaps it may seem like an inappropriate time to get in because of the volatility of foreign markets, but this is long-term investing," said Richard Purucker, administrator-pension plans.

Wisconsin Electric chose State Street Bank and Trust Co., Boston, to manage $22 million in two commingled equity funds and instructed State Street to underweight the Japanese market by an undisclosed amount.

Nancy Lange, a vice president at InterSec, said some money managers wonder whether pension executives will repatriate their assets, but "if they're getting worried, they haven't told us about it. We haven't noticed any sign of worry yet."

Allan Emkin, managing director, Pension Consulting Alliance, Glendale, Calif., said he "can state unequivocally that none of the clients I'm dealing with is reconsidering (his or her) commitment to non-dollar securities as an asset class."

Indeed, some "are considering investing more assets in order to reach a previously established target," he said.

Robert C. Elliott, senior executive vice president, Bessemer Trust Co., New York, said he doesn't know of any clients saying, "Sell me out." In fact, some of Bessemer's clients in domestic investments are considering making their first international investments in the second quarter.

He said they feel "they've postponed foreign investing for a long time."

A number of pension funds are known to be searching for international money managers.

Among those are the approximately $11 billion Virginia Supplemental Retirement System, Richmond, and the city of New York, on behalf of the $17.7 billion employees' fund, the $6.2 billion police fund and the $2.4 billion firefighters fund.

DeWitt Bowman, chief investment officer of the $55 billion California Public Employees' Retirement System, which began funding international investments last year, said market downturns won't "affect our funding schedule. We don't feel we necessarily have the ability to time markets, and with the amount we anticipate investing (a goal of 16% of the fund) we made the decision to go into (foreign markets) over a period of time. If there is weakness in the markets, it's an opportunity to buy (securities) at lower prices." About 7% of the California system's assets are invested internationally.

California fund officials have, however, altered their active fixed-income asset allocation decision-making process.

Initially, the allocation was to be made by fund officials, "and the managers would either invest internationally or domestically," said Mr. Bowman. Now, managers "have more opportunity to make that choice," he said. "It makes more sense for managers to be able to use the domestic markets if yields or returns are more attractive than in international markets."

Other markets, meanwhile, have rallied, which underscores the premise that foreign investing helps diversify assets and that markets don't necessarily march in step.

And, of course, some investors see market downturns as a chance to grab securities at bargain prices.

Many investors, for example, had been retreating from the Tokyo market — especially because of its high price-earnings ratio — so the market's recent tumble has rekindled some interest.

The rationale: The Tokyo market will rebound based on strong long-term economic fundamentals, such as Japan's balance of payments surplus, high savings rate, strength in manufacturing technology and a highly skilled and educated work force.

"Managers are watching Japan. At some point, that market will be a buying opportunity, although we may not be there yet," said John B. Carroll, president of GTE Investment Management Corp., Stamford, Conn.

Bridge

Continued from page 3

national Inc. and Jerrico Inc.

First Boston's sale was followed closely by Kidder's announcement that it was getting out of the bridge loan business by recapitalizing with $500 million from its parent and selling, among other assets, its entire portfolio of bridge loans totaling $247 million to GE Capital.

"Syndication of our bridge loans is an option," said Steven Faigan, spokesman for Shearson Lehman Hutton Inc., New York, "but no changes are yet planned."

Mr. Faigan said the size of Shearson's bridge loan portfolio had not changed since August, when the firm provided a $500 million bridge loan as part of the financing in the takeover of Prime Computer Inc., Natick, Mass., by financier J.H. Whitney. Analysts believed at that time Shearson was eager to convert the $500 million bridge loan into high-yield securities.

S&P since has downgraded the credit rating of Prime Computer.

Some investment banks, such as Morgan Stanley & Co. Inc. and Bear Stearns & Co. Inc., have taken a conservative approach to making bridge loans and hold $50 million or less each. Analysts say they are in better shape than other firms.

A spokeswoman for Morgan Stanley, which has an estimated $41 million in bridge loans, said the firm's executives believed the risks outweighed the rewards, so it followed a conservative route. Morgan Stanley, however, has commitments for a $212 million bridge loan to Fort Howard Paper Co., Green Bay, Wis., which is spinning off a subsidiary, if an alternate bridge loan is unavailable, according to the spokeswoman.

In a strategy she said few other firms are using to refinance these loans, the bank syndicates bridge loans as commercial paper to foreign investors and institutional investors.

S&P estimates revenue from activities dependent on junk-bond financing would decline by as much as 20%, hurting the profits of such active bridge lenders as Merrill Lynch Capital Markets, Shearson and First Boston.

Mr. Long said brokerage houses are "trying to get the parent company to take over the loans if they keep them. If so, (the parent) would handle it in the holding company and try to keep them out of the broker-dealer," which would have to take writedowns for capital requirements, he said.

"Failing all else, they will keep looking for ways to offload these loans," Mr. Long said.